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TAX·FEATURES

Government Spending Tops $1.58 Trillion; Now Totals $18,310 for Each U.S. Household

"Income Security" Claims 1/3 Of All Public Dollars Spent

Major social welfare programs in the United States claimed nearly 34 cents of every dollar spent by Federal, state, and local governments in fiscal year 1983 (latest data available). The costs of these programs came to $455 billion out of a spending total in excess of $1.3 trillion—33.7 cents of every dollar of government spending.

Per U.S. household, spending for these programs amounted to $5,419. Total government spending per household was $16,099.

The second most costly category in fiscal 1983 was national defense and international relations, at 16.9 cents on the dollar. Next came education (13.1 cents) and interest on general debt (9.8 cents). Per household, defense and international spending totaled $2,726; education, $2,105; and interest, $1,583.

The Federal social security system (OASDHI) is by far the largest among the major social programs. It accounted for 16.4 cents of each public expenditure dollar in 1983. Also included in the grouping are social services and income maintenance (public welfare, health and hospitals, and unemployment insurance benefits); veterans' programs that are not classified under other functions; railroad retirement; and government employee retirement. The sum of these major programs understates the size of the social welfare "spending total," broadly defined in that it excludes public education (shown separately), as well as subsidized housing and many veterans' programs for which the data are not segregable from other groupings, according to Foundation researchers.

Growth in the social programs has outdistanced that of other government programs by a wide margin. In 1983, social welfare spending was 14 times what it was in 1960, while other programs grew to only 7.5 times their size over the same two decades. The 33.7 cents per dollar share of all spending held by social programs in 1983 reflected a rise from 20.6 cents in 1960 and from 25.8 cents in 1970.

Costs for national defense and international programs in 1983 came to about half of the social welfare total, at 16.9 cents per dollar of all public spending.

While education received a somewhat higher share of public funds in 1983 than in 1960, its 13.1 cents per

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Federal, state, and local governments will spend $6,670 for every person in the United States ($18,310 per household) in the current fiscal year, according to the Tax Foundation. Total outlays will top $1.58 trillion. At this level, government outlays this year will exceed the nation's total output as measured by gross national product just ten years ago.

Compared to last year, fiscal 1985 spending will rise by an estimated $156.4 billion, or 11.0 percent. Federal spending is expected to increase by $115 billion, or 12.6 percent, while state-local outlays are expected to grow by $41.6 billion, or 8.1 percent.

On a per capita basis, government spending in fiscal 1985 is estimated at $6,670, up from $3,373 seven years ago. For each of the more than 86 million U.S. households, the government spending tab will come to $18,310 this year, as compared to $9,804 in 1978.

The Federal government accounts for about 65 percent of total public spending ($1,026.2 billion). Since 1950, the Federal share of the rising public expenditure total has remained fairly constant. Except for the period of the Korean War, when it accounted for more than 70 percent of all spending, the Federal share has ranged from a high of 69.8 percent in 1954 to a low of 60.7 percent in 1972.

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Federal, State, and Local Government Expenditures[a]

Selected Fiscal Years 1950-1985

Fiscal year	Amount (billions)			Total expenditures	
	All governments	Federal	State and local	Per household	Per capita
1950	$ 70.3	$ 44.8	$ 25.5	$ 1,614	$ 466
1960	151.3	97.3	54.0	2,866	847
1965	205.7	130.1	75.6	3,581	1,067
1970	333.0	208.2	124.8	5,252	1,643
1975	560.1	340.5	219.6	7,875	2,612
1976	625.1	389.9	235.2	8,579	2,886
1977	680.3	430.6	249.7	9,176	3,111
1978	745.4	477.8	267.6	9,804	3,373
1979	832.4	535.7	296.7	10,764	3,726
1980	958.6	615.4	343.2	11,867	4,243
1981	1,109.8	717.4	392.4	13,474	4,857
1982	1,233.5	794.7	438.8	14,768	5,345
1983	1,351.0	872.5	478.5	16,099	5,798
1984[b]	1,426.4	911.4	515.0	16,701	6,066
1985[b]	1,582.8	1,026.2	556.6	18,310	6,670

[a]Grants-in-aid are counted as expenditures of the first disbursing unit.
[b]Estimated by Tax Foundation.
Source: Basic data from U.S. Department of Commerce, Bureau of the Census; computations by Tax Foundation.

Taxes Heaviest for Top Earners Despite '81 Cuts; Few Higher Earners Turn to Tax Avoidance Schemes

"In reviewing the record one is struck immediately by the very small proportion of actual tax escapees, at least in relation to the rhetoric of some reformers."

In the fading days of the Lyndon Johnson Administration, Joseph Bar, then Acting Secretary of the Treasury, made a speech calling attention to 154 tax returns in 1966 with $200,000 or more in adjusted gross income but no Federal tax liability. It was the shot heard round the world for tax reform. Shortly afterward the drive for the Tax Reform Act of 1969 gathered steam. The new Republican Administration of Richard Nixon was caught off guard and acquiesced in a number of restrictive new provisions in the Code, including the first minimum tax. Under the 1976 Tax Reform Act, the minimum tax was stiffened considerably and other measures were adopted to force upper income individuals to pay a higher share of income taxes.

Now, along with criticism of the Reagan tax cuts of 1981 for redistributing wealth upward, there has been a renewed spurt of stories about the spread of tax shelter arrangements, despite the lower rates of tax which were supposed to discourage shelters, and on how upper income people still escape Federal income tax as a result. This sort of talk, of course, is fueling Congressional tax reform efforts and has helped prod the Administration to make quite radical proposals of its own. It's also reviving the minimum tax concept.

The Non-Payers

As one result of the 1976 Tax Reform Act, Treasury has been issuing a regular compilation of data on high income taxpayers and non-taxpayers including the importance of various tax provisions in reducing or eliminating tax liability.

The most recent data pertained to calendar 1982 with comparable statistics going back to 1966. In reviewing the record one is struck immediately by the very small proportion of actual tax escapees, at least in relation to the rhetoric of some reformers. The further you dig, in fact, in terms of the published figures, the smaller the problem looks. We hasten to add that the Statistics of Income does not, and cannot, capture the full extent of tax avoidance. More on that later. What they show is capsulized in the tables below.

The tables show that at no time in the decade ending in 1982 did non-taxpaying returns amount to more than one-half of one percent of all returns with $200,000 or more of expanded income and since 1975 they ran less than one-fifth of one percent of such returns. Expanded income includes items of tax preference subject to the minimum tax and is the nearest thing to "economic income" in the published statistics. In this sense, it is probably a more appropriate measure than adjusted gross income.

There are some other factors which tend to deflate the extent of reported upper income tax avoidance further. Up to half of the non-taxable returns in any given year were due to heavy tax payments abroad resulting in substantial foreign tax credits against U.S. tax liability. Most of the individuals involved were living and working abroad and use of the foreign tax credit here to avoid double taxation of income hardly seems to be a loophole.

Also in numerous cases a non-taxable return in any one year may well show up as taxable in another. The two items that have the largest impact in reducing or eliminating tax liability of the upper income groups are deductions for interest and state/local taxes. A large state tax or interest payment on back taxes can help wipe out Federal liability for one year although the individual taxpayer may pay a sizable Federal tax regularly in other years.

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Nontaxable Income Tax Returns With Expanded Income[1] of $200,000 or Over

(1973-1982)

	Returns	% of all returns in income class
1973	91	0.26
1974	167	0.39
1975	215	0.53
1976	53	0.10
1977	85	0.13
1978	105	0.12
1979	114	0.09
1980	198	0.13
1981	304	0.17
1982	299	0.14

[1]Expanded means equal adjusted gross income plus items of tax "preference" less investment expense. Principal "preference" items are the excluded 60% of capital gains and excess of accelerated depreciation over straight-line on real property.

Taxable Income Tax Returns With Income of $200,000 or Over

1982

	$200,000 or over of Adjusted Gross Income	$200,000 or over of Expanded Income
Returns	169,105	206,992
Average U.S. Tax Payment	$157,439	$138,501
Effective U.S. Rate of Tax	36.7%	27.5%
Average Tax Payment including Foreign Taxes	$159,845	$140,494
Effective Rate of Tax including Foreign Taxes	37.3%	27.9%
Effective U.S. Rate of Tax (% of total returns)		
Under 20%	8.0%	23.8%
20%-35%	27.7%	39.4%
Over 35%	64.3%	36.8%

Tax Features

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FEDERAL TAX POLICY MEMO

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Tax Reform and Reagan I

While getting ready for the long, hot summer, here are some preliminary thoughts on tax reform now that Reagan I is finally out in the open:

1. **Major Changes Proposed.** While pulling back on a good number of the most controversial provisions in Treasury I, the President's new proposals still would constitute the most far-reaching overhaul of the Federal income tax since the 1954 Code and, perhaps, since the 1939 Code There's lots to chew on in Reagan I. The cordial reception given to the President's proposals by the Chairman of the House Ways and Means Committee indicates Congress will take them seriously. But as always, Congress will want to apply its own tax stamp. So the sailing will not be all smooth, particularly if Congress decides to entwine tax reform with deficit reduction.

2. **More Practical.** Reagan I will be criticized for retreating from the fuller taxation of economic income in Treasury I. But it is hardly just a matter of caving in to the demands of special interests. There were serious concerns raised about our ability to raise capital for investment and compete abroad under provisions of Treasury I which were significantly modified by Reagan I. In other areas there were large questions about the administrability of Treasury I provisions such as on fringe benefits, entertainment expense and interest indexing. These needed to be addressed and were, although not all answered by any means.

3. **Business Still Bears the Brunt.** It would seem difficult to argue that the business sector is being treated with generosity under Reagan I when there is an estimated 24.5 percent increase in business tax burdens over five years compared to a 6 percent drop in individual tax burdens. There are ameliorations of business tax treatment compared to Treasury I to be sure, but there are also a new minimum tax proposal and an outright money grab through depreciation "recapture" that penalizes those who made large commitments to productive investments since 1980. In a true economic sense, of course, assuming the program is really at or close to revenue neutrality, there could be no real net "benefit" to the individual sector. As the burden of the proposed corporate tax increases ultimately would fall entirely on individuals—as shareholders, employees, or consumers—the ultimate effect on individuals would be a wash. After decades of debate we still don't know the true incidence of the corporate income tax on shareholders, workers and consumers, and in this report as in others, we resort to the shorthand of equating revenue change with change in tax burdens. In this sense, in the short term, business clearly bears the brunt.

4. **Simplification.** The tax simplification objective would be a little better served, at least in the individual sector, by Reagan I than by Treasury I even though the overall thrust of the former seems to assign somewhat less importance to simplicity. The pullback on fringe benefits and indexing, in particular, would improve compliance and planning prospects. Going the other way, however, is the proposed stiffening of minimum taxes on individuals and corporations. By their very nature minimum taxes represent tax complications even with exemption levels that eliminate most taxpayers from liability.

5. **Political Appeal.** The Administration obviously intends to push its reform package by emphasizing the individual rate reductions and relief for families by near doubling of the personal exemption. This may be a good tactic given the public's limited attention span to the intricacies of structural reform. However, if pressed too hard, the "populist agenda" approach may invite another bidding war with Congress. In 1981 the business sector was the beneficiary of additional tax concessions as a result of the competiton between the Administration and House Ways and Means Committee programs. This time it could be reversed with the business sector being subject to still higher burdens to "pay" for the liberal individual rate reduction and allowance increases, particularly if moves to broaden the individual tax base falter in Congress.

6. **Economic Impact.** At one point this Spring, we were told that the Administration proposals would be accompanied by a much more detailed and explicit statement of overall economic impact compared to the generalities of Treasury I. But as of this writing, the statement of impact consists of one obscure paragraph indicating that Treasury feels real GNP would run at least 1.5 percent higher by 1995 under the new program compared to current law. But because of the "inherent uncertainty" in such a forecast, this is not reflected in any revenue estimates nor is there any development of the case for economic efficiencies and better resource allocation under the overall program. In fact, other than a short summary, there is no tied-together analysis of the program at all—only descriptions of the individual provisions, as in the second volume of the Treasury I proposals. This is somewhat odd given the stated need to put the package to Congress as a whole.

****

Here are some further thoughts as to the major sectors of Reagan I:

Individual Rates and Structure

The President was said to be very committed to rate reduction and substantial increase in the personal exemption. It's hardly surprising, therefore, that these salient factors of Treasury I remain intact in Reagan I. The proposed three-tier rate

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structure—15%-25%-35%—and the $2,000 personal exemption are identical to those of Treasury I, while some increases over Treasury I are proposed for the zero bracket amount and the earned income credit. Also, there is a little shuffling of the brackets between Treasury I and Reagan I with the result that the 25 percent rate cuts in at a slightly lower level ($29,000 on joint returns) and cuts out at a significantly higher level ($70,000 on joint returns), thus widening the basic middle bracket to include the whole upper-middle income group. Essentially, however, the rate structure is the same as in Treasury I and, while many other provisions of Treasury I were massaged or emasculated, it was all done with reference to the fixed lodestar of rate compression and exemption increase. Structural changes in the base and their revenue consequences all had to fit with predetermined tax reductions.

Capital Gains

The most noticeable change from Treasury I on the individual side is the capital gains treatment. Here, heavy lobbying appears to have paid off with Treasury officials even admitting that the November 1984 proposal to tax all gains as ordinary income was wrong conceptually and that a preferred rate on capital gains was really necessary to attract venture capital and encourage productive investment. Efforts to carve out and define an exemption from ordinary income treatment for gains on risk investments were not successful—not surprisingly. Therefore, the logical compromise was to retain a capital gains exclusion high enough that when combined with rate reduction it still produces a significant capital gains differential. The specific proposal is for a 50 percent exclusion, the same as before 1978, which would yield a maximum capital gains rate of 17.5 percent compared to 20 percent now. Individuals would also be offered an indexing of gains alternative in the future. Depreciable business property, however, would have to be indexed and would not be eligible for the 50 percent exclusion. This sounds a little complicated but certainly would produce a better return for broad investment purposes than under Treasury I. Some investments, however, such as business real estate and section 1231 property (coal, timber, livestock, etc.) could face a double whammy—loss of the capital gains exclusion and disadvantage against alternative investments that would retain it.

Individual Base Broadening

There is base broadening in Reagan I, but, for revenue purposes, 40 percent of it is accounted for by simply striking state/local taxes as a deduction. The table below indicates the revenue impact of all other proposed increases in the individual tax base compared to elimination of the state/local tax deduction. Little wonder then that the Administration is taking a hard-nosed, no-negotiation stance on the state/local deduction. Without its repeal the hope for rate reduction is decimated, particularly considering the likelihood of Congressional softening of other base-broadening proposals.

Despite complaints from the high-tax states *most* taxpayers in all income groups would get some net benefit from the President's program, even in New York, Massachusetts, District of Columbia, etc. What the Governor of New York and some others seem to be really worried about is their increased exposure as high-tax places without the Federal deduction and the potential comparative disadvantage thereto. To the extent that Federal base broadening will automatically increase the base of state income taxes (most of them piggybacking on the Federal structure) the states could adjust their own income tax rates downward to lessen the impact of losing the Federal deduction without necessarily having to cut state services. In any event, Congress probably is going to have to buy repeal of both the state/local deduction and the two-earner deduction if it intends to carry through on rate relief of the magnitude proposed.

Estimated Revenue Pickup in Fiscal 1990 Under Reagan I

($bil)

Repeal second earner deduction	9.0
Taxation of fringe benefits	6.9
Tighten treatment of business entertainment expense, correct other "abuses"	2.3
Repeal income averaging and other "simplification"	7.6
Depreciation changes (individual only)	6.1
Repeal ITC (individual only)	7.2
Retirement savings changes	5.8
Repeal $100/$200 dividend exclusion	.7
Tighten treatment of specific "subsidies" and tax shelters of individuals	13.9
Subtotal	59.5
Eliminate deduction for state/local taxes	40.0
Total	99.5

What will ensue for all the other base-broadening proposals is much harder to assess. Many of them involve obscure areas of the Code (tightening the grantor trust rules, for example) or would make changes in areas where powerful lobbies are ready to pounce (such as eliminating industrial revenue and mortgage subsidy bonds and the business meal restrictions). But, collectively, these proposals would provide for about one-half of the total base-broadening objective for individuals. Once again, Congress would have to make some real headway here in order to justify the rate reduction.

Distribution of Individual Tax Burdens

The tax burden table accompanying Treasury I showed no change in the portion of the tax paid by different income groups compared to current law (except for the very lowest whose share was reduced). Reagan I, on the other hand, does indicate some shift in burdens with a slightly higher load on the middle and upper-middle income groups ($50,000-$100,000 in particular), a slightly reduced share at the very top (over $200,000) and a more marked reduction in the tax share of those under $20,000. The shifts in the upper range do not seem to stem from any overall plan but rather are the result of the "givens" on the rate structure and compromises on capital gains and other provisions of Treasury I that were reworked for various reasons. The net is to allow relatively more tax relief at both ends of the income scale and to skew the distribution of burdens somewhat. Although the latter effect is not particularly significant in substance, inevitably it will be seized upon by the program's detractors.

Another distribution point: The President's program is said to benefit—that is to reduce the taxes of—58 percent of all families and raise taxes on only 21 percent. The implication is that that 21 percent are not paying a fair share now and they are

mainly in the upper-income groups who would be hit by tighter rules on tax shelters, the stiffer minimum tax, etc. However, there could be some individual losers throughout the middle-income groups, particularly those who have taken heavy state/local tax deductions *and* were beneficiaries of such mundane provisions as the two-earner deduction and/or occasional use of income averaging.

Capital Recovery and Corporate Rates

"Crackers" is the latest word in the capital recovery field which seems to be more productive of slogan-acronyms than any semblance of stable tax policy. The latest proposal is the Capital Cost Recovery System (CCRS) which obviously is more generous than the Treasury I plan (RCRS) but more restrictive than current law ACRS with the investment credit. The investment credit would be repealed under Reagan I, and the proposed transition rules are very stingy. CCRS or "Crackers" itself is described as retaining the shell of economic depreciation of the Treasury I plan but adding back some front-loading of ACRS. With both indexing and some acceleration, CCRS is said to produce the same or lower overall cost of capital as under current law. But without the investment credit, equipment investments clearly would be worse off unless inflation zooms into double-digit ranges. Structures would benefit more under CCRS. As in Treasury I, the basic corporate income tax rate would be cut to 33 percent. Graduated rates for small businesses below 33 percent would be retained.

Business reaction to the CCRS proposal has been positive. But many were shocked by the unexpected depreciation "recapture" scheme. This would recoup the so-called "windfall" on investments made under ACRS with the expectation of a 46 percent top corporate rate but which under Reagan I would be subject to a 33 percent rate. The difference would be recaptured by taxing away 40 percent of the excess of accelerated depreciation over straight line since 1980. Payments would be spread over three years and the rule would apply even if the assets were not sold or otherwise disposed of. While the Treasury has a plausible case as to the existence of some windfall on past investment under a 33 percent rate, this type of retroactive cost recapture certainly has not been a feature of our tax system. Its impact, moreover, would be heaviest on those who invested the most in productive plant and equipment under the *mandatory* depreciation provisions of the Economic Recovery Tax Act of 1981 (ERTA). The objective of that legislation was to encourage such investment and now, four years later, businesses that actually pursued a stated national objective would be penalized quite severely for so doing. A rather awkward stance for business tax policy to say the least.

The windfall recapture theoretically would apply to individuals, too, but with a $400,000 threshold on total depreciation taken and a $300,000 exemption of excess depreciation, very few individuals would be affected. This appears to be a last-minute grasp for additional revenues—approximately $57 billion in the fiscal 1986-1989 period—from the business sector, occasioned, reportedly, by a shortfall in the overall revenue estimates of the program just before its release.

Other Business Provisions

Most of the other major provisions of Treasury I affecting the business sector were carried over in Reagan I, some with quite substantial modifications. Interest indexing, however, was dropped entirely as too costly and too complicated.

The Treasury I proposal for a 50 percent dividends paid deduction was cut way back to 10 percent, apparently for revenue considerations. While it is nice to see at least some recognition of the problem of double taxation of corporate earnings remaining in the program, a 10 percent deduction is pretty meager relief. The danger is that Congress will view it as relatively unimportant. Without stronger sponsorship it's unlikely to survive at all.

Much more restrictive rules with respect to multiperiod production cost accounting, heavily impacting a range of capital intensive industries, were carried over in Reagan I as were proposals to force multinational firms to use the per country limitation on the foreign tax credit and more restrictive sourcing rules for income and deductions. The President's program does make some adjustment from Treasury I in proposed treatment of foreign source income including a five-year grandfather clause for continued use of the section 936 credit applying to investment in Puerto Rico. But the thrust of the new foreign income proposals is still to produce more revenue—and severe complications for tax planning without much concern as to the U.S. multinationals' ability to compete abroad, particularly in low-tax countries.

Finally, there is the tightened corporate minimum tax proposal. The Administration justifies this as a means to ensure that all corporations with economic income will pay some tax. Because Treasury I's reach over economic income has been diluted, the offer to repeal the corporate minimum tax has been withdrawn. Obviously the Administration is responding to current political pressure in this area. While its new minimum tax proposal is pretty minimal in terms of revenue considerations, Congress is waiting in the wings with much stiffer measures.

From a tax policy view there is little good to be seen in the minimum tax concept for either corporations or individuals. As Senator Bill Bradley (D-NJ) said, "A minimum tax is an admission of failure. It demonstrates not only that the system is broke, but also that Congress doesn't have the guts to fix it." Minimum taxes also can have untoward economic consequences and surely would further complicate the system (see May 1985 *Tax Features).* But they are perceived as powerful political tools to make the system look "fairer."

The table on page 4 indicates the magnitude of the major shifts in business tax proposals between Treasury I and Reagan I. These are expressed in terms of estimated revenue consequences for the five fiscal years 1986-1990, compared to current law. These revenue estimates, of course, are on a static basis assuming no change in business behavior which is unrealistic. They are shown mainly to portray the policy directions. Revenue estimates on the effect of reducing corporate rates assume all other provisions are enacted, while the revenue effects of the other provisions assume current law rates.

As a postscript to the Economic Recovery Tax Act of 1981 (ERTA), it is interesting to remember all the froth about the deep business tax cuts that year "destroying" the corporate income tax. Since then the 1982 and 1984 acts "took back" over 85 percent of ERTA's corporate tax relief scheduled for the fiscal 1981-1990 period as a whole. Now, of course, we have

Change in Estimated Revenues
Major Corporate Tax Provisions, Fiscal 1986-1990

($bils)

	Treasury I	Reagan I
Corporate rate reduction to 33%	−203.8	−154.0
Small corporations' graduated rates	+ 31.2	− 2.0
Economic depreciation	+180.5	+ 26.0
Repeal investment credit	+123.9	+139.7
Depreciation recapture	—	+ 56.5
Dividends paid deduction	− 97.7	− 24.8
Interest indexing	− 15.3	—
Multiperiod production cost accounting	+ 41.5	+ 39.7
Percentage oil depletion and intangible drilling costs	+ 32.9	+ 2.1
Financial institutions	+ 54.8	+ 23.8
Section 936 credit	+ 3.7	+ 0.3
Other foreign source income	+ 15.3	+ 18.5
Overall corporate provisions[1]	+164.9	+118.4

[1]Includes others than listed above.

exactly the opposite direction with large corporate tax increases in the works and the corporate income tax slated for a 20 percent share of all Federal income, estate and gift, and excise taxes compared to 14 percent in the 1982-1984 period.

Revenue Neutrality and Transition

As noted, one of the touchstones of both Treasury I and Reagan I, as well as other tax reform plans in Congress, is that they be revenue neutral, at least on paper. Reagan I already is getting criticism for possible overestimating of revenues through 1990. Longer term, concern has been expressed that the revenue balance of the program could turn more decidedly negative as some of the base-broadening moves are digested and the rate reductions take hold. The Administration's basic answer here seems to be: Don't worry, better growth from economic efficiencies will take care of it.

Of more pressing concern for the interim period is the effect on households and businesses of jamming through such major structural changes on January 1, 1986, or with relatively short phase-ins. One of the more troubling examples of this is the proposed repeal of the investment tax credit for property placed in service after January 1, 1986, without honoring binding contracts or firm commitments in the manner of the 1969 repeal. Congress tends to be more liberal on transition rules, and the Chairman of the Ways and Means Committee already has indicated that he intends to be so with respect to the investment credit. But if so, presumably there will have to be additional revenue pickup elsewhere.

The quick transitions in the Reagan I program are driven by the stated need to make the full rate reductions effective at one time. In fact, the proposed timing for the rate reductions is July 1, 1986, which saves money in fiscal 1986 but makes adjustment to base-broadening measures effective six months earlier even tougher.

Nobody knows how all of this would work out simply because we have not had to deal with it before, at least to the extent of the present proposals. We do know that the Treasury would have to increase its regulations writing capacity by a large factor. Even assuming it can work down the present large backlog, the potential regulations projects under Reagan I are awesome to contemplate. Inevitably there will be serious dislocations and uncertainty for investors, businesses and their employees.

Policy Directions

Tax policy a la Reagan I appears to have distinctly different dimensions with respect to individuals and business. On the individual side, as a result of rate compression and base broadening, there is clear direction toward simplification, horizontal equity, and making taxes less important in the life of individuals as consumers and investors. The net benefit that most individuals would receive in dollar terms is not all that important for economic behavior but it may be for political acceptance of the program.

On the business side, the direction is much less certain. Reagan I is probably less divisive of the business community than Treasury I because some of the rough edges have been smoothed and the disparity of appeal between service and high-effective-rate businesses on the one hand and the capital intensive industries on the other is not quite so wide. The proposed corporate rate reduction, of course, would be substantial, and beneficial overall but significant tax burdens on the business sector are still proposed, and they would still affect mainly capital intensive business.

Treasury I would have had a unifying theme with respect to business taxation in the proposed spread of inflation indexing and theoretically, at least, better measurement of income and deductions. With the dropout of interest indexing a good part of that neat architectural arrangement is gone. So is the certainty with respect to capital recovery policy with a still quite drastic shift in the 1954-1981 trend in the works. Moreover, there are additional and troublesome new complexities proposed for business taxation in production cost accounting, in the treatment of foreign source income, for individual industry sectors and investments, and, yes, even for business entertainment. If you thought the three-martini lunch was a rallying cry only for the Carter Democrats, think again.

Finally, the reform plan does not seem to give serious weight to the problems of American business in a global context. There is virtually no mention of likely international consequences of the myriad provisions of Reagan I. It could be said that the lower tax rate structures would help make the U.S. an even more attractive place for foreign investment, both portfolio and direct investment that wouldn't require heavy capital outlays. But the cutbacks in capital cost recovery, particularly the repeal of the investment tax credit, certainly would not make it any easier for U.S. capital intensive industries to deal with increasingly stiff competition both in export markets and at home. The proposed changes in the taxation of foreign source income could put U.S. multinationals, whatever their product mix, at a competitive disadvantage vis-a-vis foreign competition in low-tax jurisdictions. The proposed treatment is much more restrictive than foreign companies face from their host governments. With the threat of a trade recession hanging over us, more attention should be paid to the impact of tax policy on the U.S. position in international trade and investment as tax reform is considered by Congress.

Individual Income Taxes Remain Chief $ Source

Individual income taxes took in the big money for U.S. governments in fiscal year 1983 (latest data available). Such taxes furnished 29.1 cents out of every revenue dollar collected by Federal, state, and local governments, according to Tax Foundation researchers.

Next came social security payroll taxes (OASDHI), at 15.8 cents per dollar of total revenue; current charges and user fees, 9.6 cents; miscellaneous general revenue (interest earnings, special assessments, etc.), 8.5 cents; property taxes, 7.5 cents; selective sales and excises, 6.8 cents; general sales taxes, 5.5 cents; and corporate income taxes, 4.3 cents.

Revenue trends during the period since 1960 highlight a number of significant modifications in the way government programs are funded.

The role of taxes in financing government services has declined relative to nontaxes. Borrowed funds, not included in the "revenue" totals, now finance a bigger share of government than any single tax other than individual income and social security. *(Continued on page 4)*

How Federal, State, and Local Governments Raise Each Dollar of Public Funds

Selected Fiscal Years 1960-1983

Source	Cents per dollar of total revenue			
	1960	1970	1980	1983
Tax revenues	82.7	82.4	78.2	74.3
Individual income	28.2	30.3	30.7	29.1
Social security (OASDHI)	7.0	11.5	15.0	15.8
Property	10.7	10.2	7.3	7.5
Selective sales and excises	12.5	9.8	6.5	6.8
Corporate income	14.8	11.0	8.4	4.3
General sales	3.5	4.8	5.5	5.5
Other taxes[a]	6.0	4.8	4.8	5.2
Nontax revenues	17.3	17.6	21.8	25.7
Current charges	8.1	7.9	8.6	9.6
Miscellaneous general revenue[b]	3.3	4.0	6.7	8.5
Employee retirement	1.9	2.5	3.1	4.0
Utilities and liquor stores	3.2	2.6	2.7	3.2
Other nontaxes	.8	.6	.7	.6
Exhibit (billions):				
Total revenues	$153.1	$333.8	$932.2	$1,181.3
Surplus (+) or deficit (-)	+$ 1.8	+$ .8	-$ 26.5	-$ 169.7

[a]Includes death and gift, motor vehicle and operators' license, unemployment compensation, and miscellaneous taxes.
[b]Includes interest earnings, special assessments, sale of property, and others.
Source: *Facts and Figures on Government Finance*, 1983, Tax Foundation, Incorporated; basic data from U.S. Department of Commerce, Bureau of the Census.

THE FRONT BURNER

By Robert C. Brown
President
Tax Foundation, Incorporated

"The Fiscal Shell Game"

The annual flimflam known as the budget debate is well underway at this writing. Given the growing pressure of the deficit, the Senate and House may be well on the way to passing their First Concurrent Budget Resolution by the time this issue of *Tax Features* arrives in the mail.

One thing is certain. Even if the much-vaunted $56-billion savings cut survives the reconciliation process, it will be worth far less than the White House and the Congress would have us believe. It was never worth $56 billion to begin with. $35 billion is about all the real money that is involved in this debate.

What is at work here is a long-standing fiscal shell game. First, Administration and Congressional budget-makers choose the rosiest assumptions available about the growth of the economy and the decline of interest rates. This means they can project higher tax revenues and lower interest payments on the staggering Federal debt.

Next, comes what can only be described as baseline bingo. The budgeteers shop around among projections by the Office of Management and Budget and the Congressional Budget Office concerning the costs of various Federal programs: defense, social welfare, agricultural, etc. They select levels of spending that would never have occurred, cut huge hunks of those paper outlays, shift costly items on or off budget at will, then claim massive cuts in outlays made at great personal pain.

This slight of hand fools no one in Washington. It fools fewer and fewer voters and taxpayers in the rest of the country. But, from a public relations perspective, it produces a win-win situation for virtually everyone in the Executive and Legislative Branches.

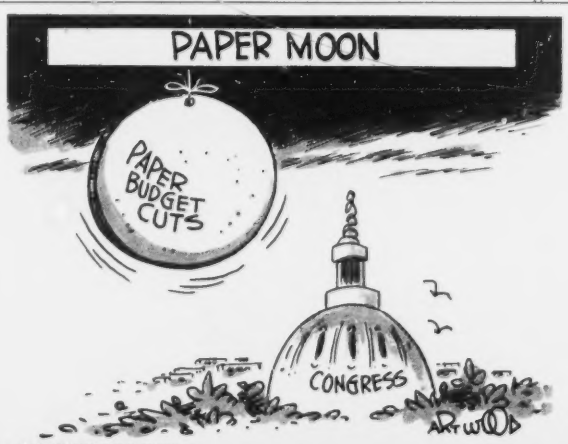
The White House is able to claim a responsible budget that moves the nation, if not toward budget balance, at least toward "reasonable" deficit levels by the end of the decade. Everyone in the Congress can send the next constituent newsletter to the folks back home painting their efforts in the best possible light.

Hawkish conservatives can claim they have kept a lid on runaway welfare spending. Dovish liberals claim they have taken a whack at the bloated Pentagon budget.

Meanwhile, Federal spending levels grow, the size of the net Federal tax take grows, and the national debt soars into the wild blue yonder.

Is it any wonder that our elected leaders are having a hard time interesting most of the populace in either deficit reduction or tax reform? As the old tune says, "It seems to me I've heard that song before."

"Even if the much-vaunted $56-billion savings cut survives the reconciliation process, it will be worth far less than the White House and the Congress would have us believe."



(INCOME SECURITY, from page 1)

dollar claim on the total in 1983 declined from 16.7 cents in 1970 and 15.0 cents in 1980.

The fastest growing cost of government in recent years has been interest on general debt, which rose from 6.2 cents per dollar in 1960 to 9.8 cents per dollar of total spending in 1983.

The four largest categories of spending—major social welfare, defense and international relations, education, and interest—accounted for a combined total of 73.5 cents per dollar of all spending in 1983, or $11,834 per U.S. household.

The table below provides further details.

How Federal, State, and Local Governments Spend Each Dollar of Public Funds

Selected Fiscal Years 1960-1983

Function	Cents per dollar of total spending			
	1960	1970	1980	1983
Major social welfare programs, total	20.6	25.8	33.6	33.7
Social security (OASDHI)	7.1	10.8	15.6	16.4
Social services and income maintenance[a]	8.5	10.7	13.0	12.7
Government employee retirement	1.4	1.9	3.0	3.0
Veterans (not elsewhere classified)	2.5	1.6	1.3	1.2
Railroad retirement	.6	.5	.5	.4
Veterans' life insurance	.4	.3	.1	.1
National defense and international relations	32.3	25.3	15.6	16.9
Education	12.8	16.7	15.0	13.1
Interest on general debt	6.2	5.5	7.9	9.8
Environment and housing	5.4	4.4	4.9	5.4
Utilities and liquor stores	3.4	2.8	3.8	3.9
Transportation	7.6	6.2	4.4	3.4
Public safety	1.8	2.0	2.3	2.3
Government administration	1.8	1.9	2.2	2.1
Postal service (Federal)	2.5	2.3	1.9	1.7
Sanitation	1.1	1.0	1.4	1.2
All other	4.5	6.1	7.0	6.5
Exhibit (billions):				
Total spending	$151.3	$333.0	$958.7	$1,351.0

[a]Includes public welfare, hospitals, health, and unemployment insurance benefits.
Source: Department of Commerce, Bureau of the Census; and Tax Foundation computations.

(GOVERNMENT SPENDING, from page 1)

In the past seven years, total government spending has more than doubled, rising from $745.4 billion in 1978 to $1,582.8 in 1985. Federal spending has risen by 115 percent, while state and local spending from their own sources has risen by 108 percent.

Total government expenditures moved up from 21.3 percent of GNP in 1950, to 26.9 percent in 1960, 31.6 percent in 1970, and 34.3 percent in 1984.

The state-local share of this spending has declined in relation to GNP, from 11.0 percent in 1970 to 10.3 percent in 1984. Federal outlays have risen from 20.6 percent of GNP in 1970 to 24.0 percent in 1984.

The table on page 1 provides further details.

(INDIVIDUAL INCOME TAXES, from page 3)

The share of taxes in the revenue dollar dropped from 82.7 cents in 1960 to 74.3 cents in 1983; nearly all of the reduction came after 1970.

Social security taxes, the fastest growing revenue source, have more than doubled their share in the total revenue system. In 1983 they were more than 17 times as large as they were in 1960.

The table on page 3 provides further details.

(TOP EARNERS, from page 2)

The Payers

Of the 1982 *taxable* returns in the $200,000 and over group, three-fourths paid at an effective rate in excess of 20 percent in terms of expanded income and over one-third paid in excess of 35 percent. We use *effective* tax rates—total tax divided by total income—in these comparisons because they are appropriate for considering the distribution of tax burdens. Bear in mind, however, that the *marginal* tax rate—rate of tax paid on an additional dollar of income—is always much higher. For this level of income, marginal rates, which have a critical impact on work and savings incentives, uniformly would be at or close to 50 percent for Federal income tax.

Actual amounts of tax incurred by the high income group *averaged* $138,500 in 1982 further indicating the substantial tax burden of upper income taxpayers. This pattern is confirmed by Tax Foundation annual compilations of the share of total Federal income tax paid by the top percentiles of income. (See May 1985 *Tax Features*.) And, oh yes, the Federal income tax is still progressive, too. Effective rates of tax show a fairly steep rise through the income brackets, at least as measured by adjusted gross income in 1983.

None of the foregoing, of course, is addressed to the undeniable opportunities that *all* income groups have to reduce or eliminate tax liability by reducing reported income above the line—that is, before adjusted gross income is defined. These opportunities include outright tax evasion and fraud—non-reporting of income, which is a major problem, but which no minimum tax or similar legislation is going to catch anyway. They include abusive tax shelters, designed to yield large writeoffs from income because of artificially inflated deductions or losses. The IRS, armed with new penalty rules, is waging an aggressive campaign against abusive shelters. There are legitimate partnership tax shelters and tax exempt income from municipal bonds and industrial revenue bonds. It would be possible, of course, for individuals with no earned income to have substantial investment income from municipals and pay no Federal tax. Tax exempt interest, however, cannot shelter earned income or other passive income from tax.

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Whatever the shelter opportunities, it's apparent that high income individuals as a group do pay substantial tax burdens and those paying no or very little tax are a distinct minority. This does not answer all the questions raised about "horizontal equity" and by those urging a new minimum tax. But it does put them in perspective.

Fall Seminar Planned

A Tax Foundation Seminar on the tax treatment of retirement savings and fringe benefits will be held on **Wednesday, September 18, 1985, in Washington, D.C.**

Further details and reservation information will appear in *Tax Features* or call the Tax Foundation at 202/822-9050.

8/30/85 R9050-3 A

TAX FOUNDATION'S VOL. 29, NO. 7 AUGUST 1985

TAX·FEATURES

'81 Tax Cut and Slow Inflation Boost U.S. Family's Buying Power

The "prototypical" family—one earner, employed full-time year-round, married, with two dependent children—has nearly 4 percent more to spend in 1985 than it did in 1981, according to Tax Foundation economists. The U.S. family's purchasing power has risen for four years, after hitting a 10-year low in 1981.

Measured in constant 1985 dollars, the family's real income after direct Federal taxes has gone up by $764 in the last four years, say researchers at the Washington-based tax watchdog organization. The upturn in real income followed six years of decline.

Because of the reductions in the Economic Recovery Tax Act of 1981 (ERTA) and the recent slowing in the rate of inflation, real purchasing power has risen each year since 1981. In sharp contrast to experience during the previous six years, Federal direct taxes for this family have risen by less than 4 percent a year since 1981, and consumer prices have gone up by only a bit more than 4 percent annually. At the same time, the family's nominal income has increased an average of 5 percent each year.

The gains to date, however, still leave the family's real after-tax income lower than it was 10 years ago. For the decade, inflation and Federal taxes have cut the family's purchasing power, measured in constant 1985 dollars, by $2,535 or 10 percent.

From 1975 through 1981, inflation and rising Federal taxes slashed $3,299 (in constant 1985 dollars), or 14 percent, from the buying power of this prototypical family. During those years, increases in Federal income and social security taxes averaged nearly 11 percent annually, inflation was climbing at the rate of 9 percent a year, and the workers' pre-tax nominal income was rising by 7 percent annually.

From 1975 to 1985, while pre-tax income was rising by 85 percent, from $14,156 to $26,153, direct Federal taxes were climbing by 114 percent, from $1,997 to $4,287. Income tax liabilities went from $1,172 to $2,443, an increase of $1,271 or 108 percent. Social security taxes jumped from $825 to $1,844, or 124 percent, as increasing amounts of revenues were needed to pay for the higher benefits resulting from the indexing of those benefits to the Consumer Price Index (CPI) as well as the increase in the number of beneficiaries.

As a proportion of the family's income, direct Federal taxes ranged from a low of 14.1 percent in 1975 to a high of 17.2 percent in 1981. In 1985, these taxes are estimated to be 16.4 percent of the family's income.

While the rise in direct Federal taxes reduced the family's gain as measured in nominal dollars by $2,290, its income gain, before taking inflation into account, was still $9,707, or 80 percent for the 1975-1985 decade.

During those years, the price level, as measured by the CPI, more than doubled, bringing the purchasing power of each dollar down to 50 cents, measured in 1975 dollars. The combination of rising prices and a rising tax bite cut the purchasing power of the family 10 percent for the decade.

The table below provides further details on median family incomes before and after direct Federal taxes and inflation, for the years 1975 through 1985.

THIS ISSUE:

PAGE 1:
Family Buying Power

PAGE 2:
OECD Taxes

PAGE 3:
Property Tax

INSERT:
Business Tax Burdens/VAT

Median Family Incomes Before and After Direct Federal Taxes and Inflation

1975-1985

Year	Median family income[a]	Direct Federal taxes: Income tax[b]	Direct Federal taxes: Social security	Direct Federal taxes: Total	After-tax income: Current dollars	After-tax income: 1985 dollars[c]
1975	$14,156	$1,172	$ 825	$1,997	$12,159	$24,401
1976	15,016	1,388	878	2,266	12,750	24,194
1977	15,949	1,466	933	2,399	13,550	24,149
1978	17,318	1,717	1,048	2,765	14,553	24,094
1979	19,048	1,881	1,168	3,049	15,999	23,808
1980	20,586	2,143	1,262	3,405	17,181	22,521
1981	21,462	2,267	1,427	3,694	17,768	21,102
1982	23,036	2,342	1,543	3,885	19,151	21,429
1983	23,949	2,278	1,605	3,883	20,066	21,754
1984[d]	25,026	2,330	1,677	4,007	21,019	21,856
1985[d]	26,153	2,443	1,844	4,287	21,866	21,866

[a]Median income for all families with one earner employed full-time, year-round.
[b]Married couple filing joint return, two dependent children.
[c]Adjusted by Consumer Price Index of the Bureau of Labor Statistics. Assumes 4% inflation in 1985.
[d]Estimated by Tax Foundation.
Source: U.S. Department of Commerce, Bureau of the Census; U.S. Department of Labor, Bureau of Labor Statistics; Treasury Department, Internal Revenue Service; and Tax Foundation computations.

Tax Treatment of Retirement Savings

Tax Foundation will sponsor a seminar on the "Tax Treatment of Retirement Savings" on **Wednesday, September 18, 1985, at the Sheraton-Carlton Hotel in Washington, D.C.**

Analysts from Congress, the Treasury, and private industry will explore the implications of proposed changes on the U.S. retirement system, evaluate policies in the legislative package now taking shape in the House and Senate, and explore alternative methods for handling retirement benefits.

For further details and reservation information, please call the Tax Foundation at (202) 822-9050.

OECD Countries' Political and Economic Ties Do Not Mean Uniformity in Tax Policy Approaches

"Taxes on goods and services are second to income taxes as revenue raisers in all the OECD nations combined, providing an average of 29 percent of tax revenues."

In spite of economic and political ties, the member nations of the Organization for Economic Cooperation and Development (OECD) display great disparity in their tax structures. In 1982, for example, the share of individual and corporate income taxes ranged from less than 20 percent of total taxes in France and Greece to 69 percent in New Zealand, 57 percent in Turkey, and more than 55 percent in Australia and Denmark. The high shares of income taxes are largely due to the absence of payroll taxes to support social security in the four nations relying most heavily on income taxes, according to Tax Foundation analysis.

On an unweighted average basis, income taxes furnish about 40 percent of taxes in the 23 OECD countries combined. The U.S. share—45 percent—puts this nation in seventh place.

For individual income taxes alone, France recorded the lowest share (13 percent) for an OECD member in 1982. At the other end, New Zealand attributed 61 percent of its tax collections to this source. Denmark as well raised more than half of its revenues from individual income levies. The United States ranked seventh among the member countries, at 38 percent.

Corporate profits tax levies also generate significant revenue contributions for some of the member countries. Japan raised nearly one-fifth of its 1982 receipts by taxing corporate incomes, ranking highest among the OECD nations by this measure. Seven percent of total tax receipts were derived from corporate income taxes in the United States in 1982. Denmark, by contrast, raised less than 3 percent of its revenue by taxing corporations.

Taxes on goods and services (sales or consumption levies) are second to income taxes as revenue raisers in all the OECD nations combined, providing an average of 29 percent of tax revenues. The United States—receiving only 17 percent of its receipts from such taxes—ranks 21st among the 23 members in its reliance on consumption levies. Only Japan (15 percent) and Italy (16 percent) derived a lesser proportion of total taxes from goods and services. Three major industrialized countries—France, Germany, and the United Kingdom—obtained 25-to-30 percent of tax receipts from consumption taxes.

Social security levies—payroll taxes—follow income and consumption taxes as major revenue sources for OECD countries, providing about 24 percent of all tax receipts on average. Variations from country to country, however, are significant. Australia and New Zealand, for example, do not levy payroll taxes to support social security programs; and Denmark gets less than 3 percent of its tax revenues from such levies. In contrast, social security accounted for 47 percent of Italy's 1982 tax receipts; and for more than 40 percent of total tax revenues in France, Spain, and the Netherlands. The United States ranked near the middle (14th), getting 28 percent of its taxes from social security levies.

Property taxes generally are not a major source of tax revenues in OECD countries, providing an average of only 5 percent of total taxes. In 1982, the United Kingdom ranked first in its reliance on property taxes (13 percent of the total), followed by the United States (10 percent), and Canada (9 percent.)

Another way to compare tax systems among the major industrialized countries is to examine the size of their tax receipts in relation to economic production, as measured by gross domestic product (GDP).

By this standard, Sweden is the "most taxing" nation, receipts coming to just over 50 percent of GDP in 1982. Norway ranks second at 48 percent. U.S. taxes in 1982 came to 30 percent of GDP, placing this country 20th among its OECD affiliates. At the low end, Spain and Turkey raised taxes amounting to 25 and 20 percent of GDP, respectively.

A table furnishing complete details is available from the Tax Foundation.

WORDS TO PONDER

"The budget stalemate seems hopeless—because we've lost our perspective. Government can survive without a budget agreement. Remember 1983. We were foundering, unable to pass a modest tax increase or a spending package. But spending was kept in relative check, and we came right back with a $50 billion tax bill that passed last May (1984)."

Rep. Dan Rostenkowski
Chairman, House Ways & Means Committee
National Press Club
July 30, 1985

EDITOR'S NOTE: Forget about 1983. Remember 1984.

New Publication

"Memorandum on the Allocation of the Federal Tax Burden and Federal Grants-in-Aid by State, Fiscal Year 1984" is now available from the Tax Foundation's Public Information Department. This 10-page memorandum presents a state-by-state comparison of Federal grants-in-aid to state and local governments for fiscal year 1984 and the Federal tax burdens that support grants.

Single copies of the memorandum are available for $4.00, plus $1.00 postage and handling per order.

Tax Features

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FEDERAL TAX POLICY MEMO

AUGUST 1985

Editor: Edward A. Sprague, Vice President–Tax and Economic Affairs

Business Tax Burdens

It was commonly observed in the aftermath of the 1981 tax bill (The Economic Recovery Tax Act—ERTA) that the Federal corporate income tax was dead; that no corporation with a half-awake tax accounting department would need to pay corporate income taxes. That was a wild exaggeration but Congress has been taking the charge to heart ever since. It already has taken back, of course, a lot of the 1981 tax benefits to the business sector. It pays close attention to each new "study" of effective corporate income tax rates and other materials purporting to show how slim the corporate share of taxes has become. Tax reforms pending before Congress would increase drastically the overall burden of corporate taxes, and even if these reforms do not advance, there are others waiting in the wings to stiffen the corporate minimum tax, to ensure that corporations pay their "fair share."

The reasons for the decline in overall corporate tax receipts as a percent of total Federal tax receipts have been fairly well documented. They include a long-term decline in corporate profits as a percent of national income, the relatively very fast growth in payroll taxes compared to all income taxes, and, yes, the special tax provisions such as the Accelerated Cost Recovery System (ACRS) and other provisions designed to spur corporate investment, exports, research and development and other activities.

More recently, the focus has turned on (1) the wide variation in corporate effective tax rates associated with investment in different industries and asset categories; and (2) the extent to which individual corporations with significant "economic income" manage to escape with little or no Federal tax liability. In the first category are all the recent critiques of ACRS based on hypothetical application of assumed discount and inflation rates to individual types of investments. Ignored in the process is the real world condition that firms must operate with a mix of assets both tangible and intangible, and that the possibility of a negatve tax rate that might theoretically obtain from a firm's particular equipment investment, utilizing the investment tax credit and ACRS, is much more unlikely to apply to the firm as a whole. Nevertheless, say the critics, these analyses are important to show how far we have strayed from "tax neutrality."

The other type of effective rate study typically examines the financial reports of selected corporations or groups of corporations comparing book provision for taxes with reported income. These studies may or may not account properly for the effect of taxes paid to foreign countries, loss carryovers and other timing factors. However, their hallmark is selectivity, zeroing in on particular corporations which for one reason or another in any given period pay low or no effective rates of Federal income tax. These studies typically have been sponsored by individual Congressmen or advocacy groups calling for stiffer tax treatment of the corporate sector.

The measurement of effective rates of corporate income tax is a controversial exercise. The Treasury Department has attempted, on occasion, to provide an overall analysis and some methodology to account for accelerated depreciation and other timing differences, loss carryforwards, etc. The last such effort was released in 1978 and applied to 1972 data which, obviously, is now obsolete. The Treasury may have a potential disclosure problem in terms of releasing detailed industry-by-industry figures because in some cases, one company may dominate a category. But Treasury now appears reluctant to even approach the subject generally.

In this context, the Tax Foundation plans to renew its series of special reports on corporate tax burdens as well as tracking individual and total tax burdens, of course. We will approach the matter from several angles, but because of data and resource limitations, will confine the analysis to overall trends in the corporate sector.

We also must bear in mind that the ultimate burden or incidence of corporate taxes is always borne by people, not inanimate corporate structures. Investors, workers or consumers ultimately will bear the burden depending on the economic circumstances of the industry. Because the precise proportions are not known and the process is obscured from public view, the corporate income tax in particular is a hidden tax and, as such, always more susceptible to political manipulation. As long as Congress and the Administration insist on revenue counting and estimating procedures showing "individual effects" and "corporate effects," we are forced to go along with this terminology and the fiction of the corporate tax burden as an entity in itself.

All this is prelude to some overall figures and comments on the extent of corporate taxes as shown on the next page.

Commentary

The national income accounts series contains a broad measure of corporate profits (Column A) that result from current production of U.S. corporations. It includes net inflows of foreign earnings but excludes corporate capital gains and intercorporate dividends of domestic corporations. Depreciation allowances are calculated on the same basis as corporate tax return information. There are several differences in coverage and definition from net profits (receipts less deductions) reported in the IRS Statistics-of-Income. However, in most years the differences tend to offset each other and the two series run quite parallel in overall totals.

Conceptually, corporate profits tax accruals (Column B) should track more closely with budget receipts of corporate income taxes given today's full acceleration of corporate tax payments. However, the accrual figures do include earnings of the Federal Reserve System which are deposited in the U.S. Treas-

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I—Federal Corporate Income Taxes
National Income Accounts Series
(1950-1984)

Year[a]	(A) Total Corporate Profits Before Tax ($ bil.)	(B) Federal Corporate Income Tax Accruals ($ bil.)	(C) Effective Rate of Federal Tax (B/A) (%)
1949-1950-1951	38.9	16.2	41.6
1954-1955-1956	45.8	19.6	42.8
1959-1960-1961	50.7	21.8	43.0
1964-1965-1966	75.6	28.8	38.1
1970[b]	75.4	30.6	40.6
1971	86.6	33.5	38.7
1972	100.6	36.6	36.4
1973	125.6	43.3	34.5
1974	136.7	45.1	33.0
1975	132.1	43.6	33.0
1976	166.3	54.6	32.8
1977	194.7	61.6	31.6
1978	229.1	71.3	31.1
1979	252.7	74.2	29.4
1980	234.6	70.3	30.0
1981	221.2	65.7	29.7
1982	165.5	46.6	28.2
1983	203.2	59.8	29.4
1984	235.7	69.7	29.6

[a]Periods before 1970 are three-year averages to dilute effect of business cycle swings.
[b]Includes some effect from Vietnam period surcharge.

ury. On a fiscal year basis these earnings amounted to $15.7 billion and $14.5 billion, respectively, in 1984 and 1983, and their inclusion tends to inflate both the corporate tax accruals and raise the estimated effective corporate tax rate (Column C). For some years, however, budget receipts of corporate payments ran ahead of accruals anyway.

The national income accounts series does provide a consistent and reasonably accurate overview of corporate profits and their taxation in the overall economic context. It does show a downtrend in the effective rate of Federal corporate income tax since the 1960s, due mainly to the expanded investment credit and other special provisions (not reflecting depreciation provisions) but also indicates that the corporate income tax has been a significant factor right along.

While Federal corporate income taxes have risen a little over 50 percent in the last decade, state/local income taxes have jumped almost 200 percent and in 1984 amounted to over a quarter of the Federal levy. The combined Federal and state/local effective corporate income tax rate, therefore, showed a smaller dip in the 1970s and has risen slightly since 1979.

The largest element of the business tax burden, however, is now the payroll tax sector, particularly for Federal social security and hospital insurance but also for state unemployment insurance and other social insurance funds. These taxes are not imposed on net income, and some economists argue that even the employer share of payroll taxes is borne by employees in lower-than-otherwise compensation. But payroll taxes are a cost of doing business and, particularly in labor-intensive industries, constitute a very large burden. Where labor is relatively scarce and/or subject to rigidities in compensation, that burden may be absorbed by the employer or the consumer.

In any event, the corporate share of payroll taxes has outstripped corporate income taxes decisively as of 1981, and will go well over $100 billion this year. When the corporate share of payroll taxes is combined with corporate income taxes, they reached an amount equivalent to 85 percent of corporate profits in 1982 and only a little below that level in 1984 (Column G).

Even without considering some other major business taxes, such as the Federal windfall profits tax on petroleum and the very substantial state/local property taxes on business, it's apparent that the overall business tax burden is large and growing. It shows no sign of fading away despite special tax relief provisions of the last two decades.

II—State/Local Corporate Income Taxes and Corporate Payroll Taxes
National Income Accounts Series
(1972-1984)

Year	(D) State/Local Corp. Income Tax Accruals ($ bil.)	(E) Effective Rate of Federal and State/Local Tax (B + D/A) (%)	(F) Corporate Payroll Taxes[a] ($ bil.)	(G) Income and Payroll Taxes as % of Corp. Profits (B + D + F/A) (%)
1972	5.0	41.4	22.7	63.9
1973	5.8	39.1	30.0	63.0
1974	6.5	37.7	33.2	62.0
1975	7.1	38.4	33.7	63.9
1976	9.3	38.4	40.0	62.5
1977	11.1	37.3	45.6	57.2
1978	11.9	36.3	53.9	55.6
1979	13.4	34.7	62.5	59.4
1980	14.5	36.1	67.0	64.7
1981	15.4	36.7	77.7	71.8
1982	14.0	36.6	80.7	85.4
1983	16.0	37.3	88.0	80.6
1984	18.8	37.5	99.4[b]	79.7

[a]Includes corporate employer share of OASDHI, state unemployment insurance tax, Federal unemployment tax, railroad unemployment insurance and retirement, and workers' compensation.
[b]Estimated.

Sources for I and II: Economic Report of the President, various years, and unpublished statistics of the Bureau of Economic Analysis, Department of Commerce.

* * * * * *

Per Capita Property Taxes Jump 40% from '76 to '83

Per capita property taxes in the major metropolitan areas of the nation vary widely in levels and rates of growth. Averaging $440 per person in 1983, property taxes in the major Standard Metropolitan Statistical Areas (SMSAs) were 42 percent higher than in 1976.

All together, the 75 largest metropolitan areas get 38.9 percent of their general revenues from state and Federal governments and raise the remaining 61.1 percent from taxes and other sources. All taxes combined provide 40.8 percent of local general revenues; property taxes alone make up 29.2 percent of local revenues, and 72.3 percent of locally raised taxes.

In ranking per capita property taxes in the largest 40 areas, Tax Foundation analysts note that the Nassau-Suffolk area in New York leads other places by a wide margin, with per capita property taxes in fiscal 1983 of $944. It was followed by Newark, New Jersey ($668); the New York-New Jersey area ($625); Houston, Texas ($616); and Detroit, Michigan ($604). Other SMSAs in the top ten were: Boston ($602); Hartford-New Bedford-Bristol, Connecticut ($595); Milwaukee ($566); the Washington, D.C.-Maryland-Virginia area ($541); and Portland, Oregon ($537).

Lowest per capita property taxes among the 40 largest areas were found in New Orleans, Louisiana

(Continued on page 4)

THE FRONT BURNER

By Robert C. Brown
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"Apples and Oranges"

Two Martians landed their flying saucer in a field in the southwestern United States. They made their way into a country-western bar on the outskirts of a nearby town. Just inside the door, blaring and blinking for all it was worth, stood an elaborate juke box—a veritable carnival of flashing lights and sparkling chrome—pumping out a torrent of western music.

One of the Martians sidled up to the garish record-player, winked each of his six eyes in succession, and said, "What's a nice girl like you doing in a place like this?"

Some of the elements in the current tax policy debate seem as out of place in the tax bill as Martians in a western saloon.

The assault on employee benefits is a good example, especially proposals that will undermine the personal capital formation options now available to American workers.

Ours is a redistributive income tax system, taking more from those who have enjoyed the benefits of the economy and transferring what has been collected to those farther down the economic scale. Within reasonable limits, this is laudable. However, one has to ask what sense it makes to deprive American workers of capital formation options in order to underwrite other provisions that are preferred by the current crop of tax writers. Is it sound policy to tax capital built up under annuity and whole-life insurance policies and discourage the popular 401K plans even if the laudable purpose of general rate reduction is said to be served by such "base broadening"?

Actually, a good many of the myriad changes proposed would have very little revenue impact. But they all would impact seriously the administration of all major types of retirement and benefit plans, affecting deductions and contributions, distributions, loans, anti-discrimination rules, plan terminations, contributory basis recovery, etc. The proposed anti-discrimination rules alone, in the name of uniform treatment of welfare and retirement plans, would threaten the continuation of some welfare plans even where benefit coverage is identical for all employees.

Undoubtedly some of the proposed changes have merit from a reform viewpoint. But they would amount to another whole ERISA (Employee Retirement Income Security Act of 1974) hooked on to even larger tax revision. It took years to enact ERISA because of the complexity of the issues involved and now we are trying to redo it in a few months. How much reform can we stomach at one time?

Major labor relations questions are at stake. So are decisions about who shall care for aging Americans and their survivors, how that care is to be paid for. Finally, there is the over-riding consideration that the individual ought to be free to decide what kinds of future security he needs, wants, and is willing to pay for.

These issues, however, are not close to everyone's heart. Big taxers don't like them. Advocates of government as Big Brother don't like them. Those who seek to impose stifling rules on private sector initiative in the name of "uniformity" don't like them.

That's what's really behind the drive to finesse some very major policy changes through a Congress desperately looking for ways to appear to be doing something serious about tax reform and deficit reduction. That's why it's important for those who see what is really happening to raise their voices against mixing the apples of policy shifts with the oranges of tax reform—real or imaginary. The retirement income proposals should be split off from tax reform and considered separately and more deliberately at another time.

"One has to ask what sense it makes to deprive American workers of capital formation options in order to underwrite other provisions that are preferred by the current crop of tax writers."

(PROPERTY TAXES, from page 3)

($164); San Antonio, Texas ($238); Seattle ($266); Phoenix ($276); Tampa-St. Petersburg ($294); and Sacramento ($297). Following closely were St. Louis ($300); Columbus, Ohio ($302); and Baltimore ($303).

Areas most heavily dependent on property taxes as a source of local revenues tend to have the highest levels of per capita property taxes, according to Tax Foundation analysts, although the correlation is not perfect. The Hartford area in Connecticut had the highest dependency ratio, receiving 55.7 percent of its revenues from property taxes; its per capita ranking was seventh. Nassau-Suffolk, with the second highest dependency ratio of 49.3 percent, ranked first in per capita levels. Other areas with high scores on dependency and high rankings in per capita levels were Newark, Boston, Houston, Detroit, Portland, Chicago, and Milwaukee. On the other hand, the Dallas-Fort Worth area ranked tenth in the extent to which it depends on property taxes as a revenue source, but fell 18th in per capita levels. New York-New Jersey, 29th in dependency ratio, was third from the highest in level; and the Washington, D.C. area, 23rd in its dependency ratio, stood ninth in per capita property tax level.

"Areas most heavily dependent on property taxes as a source of local revenues tend to have the highest levels of per capita property taxes."

The seven-year trend in property tax levels shows the profound effects of Proposition 13 on the seven California areas that are among the nation's top 40 in population size. All seven of the California areas except Anaheim were paying lower per capita property taxes in 1983 than in 1976. In contrast, the areas outside California all reported increases.

In areas outside California, the 1976-83 increases ranged from lows of 25 percent in Boston and 27 percent in Phoenix to 115 percent in Houston, 99 percent in Pittsburgh, 98 percent in Fort Lauderdale, 92 percent in Tampa-St. Petersburg, and 90 percent in the Washington, D.C. area.

The table below provides details.

Per Capita Local Property Taxes in Relation to Total Local Revenues
All Local Governments in Selected Standard Metropolitan Statistical Areas

Fiscal Years 1976 and 1983

Area[b]	Per capita property tax: Amount 1976	Amount 1983	Percent change	Rank[c] 1983	Property tax as a percent of local revenue[a]—1983: Percent	Rank[c]
Total, 75 major SMSAs	$310	$440	+ 42	—	29.5	—
Anaheim-Santa Ana-Garden Grove, California	366	395	+ 8	22	29.0	18
Atlanta, Georgia	256	411	+ 61	19	28.4	20
Baltimore, Maryland	196	303	+ 55	32	22.9	30
Boston, Massachusetts	483	602	+ 25	6	43.3	4
Buffalo, New York	307	468	+ 52	14	27.9	22
Chicago, Illinois	319	531	+ 66	11	37.2	8
Cincinnati, Ohio-Kentucky-Indiana	197	317	+ 61	28	28.2	21
Cleveland, Ohio	286	405	+ 42	20	25.9	25
Columbus, Ohio	193	302	+ 56	33	25.5	27
Dallas-Fort Worth, Texas	247	419	+ 70	18	33.4	10
Denver-Boulder, Colorado	284	443	+ 56	15	28.7	19
Detroit, Michigan	352	604	+ 72	5	40.7	6
Fort Lauderdale-Hollywood, Florida	223	442	+ 98	16	31.6	12
Hartford-New Britain-Bristol, Connecticut	383	595	+ 55	7	55.7	1
Houston, Texas	286	616	+ 115	4	41.0	5
Indianapolis, Indiana	253	343	+ 36	26	31.5	13
Kansas City, Missouri-Kansas	241	310	+ 29	31	25.6	26
Los Angeles-Long Beach, California	419	314	− 25	30	18.6	36
Miami, Florida	245	438	+ 79	17	26.9	24
Milwaukee, Wisconsin	331	566	+ 71	8	34.2	9
Minneapolis-St. Paul, Minnesota-Wisconsin	316	491	+ 55	13	29.5	16
Nassau-Suffolk, New York	609	944	+ 55	1	49.3	2
Newark, New Jersey	493	668	+ 35	2	44.3	3
New Orleans, Louisiana	93	164	+ 76	40	12.8	40
New York, New York-New Jersey	438	625	+ 43	3	24.3	29
Philadelphia, Pennsylvania-New Jersey	237	392	+ 65	23	29.1	17
Phoenix, Arizona	218	276	+ 27	37	17.5	39
Pittsburgh, Pennsylvania	199	397	+ 99	21	31.4	14
Portland, Oregon-Washington	328	537	+ 64	10	37.5	7
Riverside-San Bernardino-Ontario, California	352	316	− 10	29	19.3	35
Rochester, New York	328	525	+ 60	12	32.6	31
Sacramento, California	333	297	− 11	35	18.4	37
St. Louis, Missouri-Illinois	228	300	+ 32	34	29.7	15
San Antonio, Texas	148	238	+ 61	39	22.6	31
San Diego, California	341	320	− 6	27	20.9	33
San Francisco-Oakland, California	493	389	− 21	25	20.1	34
San Jose, California	435	392	− 10	24	22.5	32
Seattle-Everett, Washington	193	266	+ 38	38	18.3	38
Tampa-St. Petersburg, Florida	153	294	+ 92	36	25.2	28
Washington, D.C.-Maryland-Virginia	285	541	+ 90	9	27.1	23

[a]General revenues only; excludes revenues for insurance trust operations.
[b]These are the 40 most populous Standard Metropolitan Statistical Areas according to estimated population as of April 1, 1980, and contain 11,600 local governments.
[c]Rank among 40 most populous areas.
Source: Department of Commerce, Bureau of the Census; and Tax Foundation computations.